

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
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In the Matter of)
)
Price Cap Performance Review) CC Docket No. 94-1
for Local Exchange Carriers;)
Treatment of Video Dialtone Services)
Under Price Cap Regulation)

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NYNEX REPLY COMMENTS

The NYNEX Telephone Companies ("NYNEX")¹ submit these Reply Comments to parties' comments filed April 17, 1995, in response to the Commission's Further Notice of Proposed Rulemaking ("Notice") in the above-captioned matter. We address here proposals relating to the application of price cap regulation to video dialtone ("VDT") service, including basket structure, productivity factor, price floor, Part 69 treatment and sharing/low end adjustment mechanisms.

I. GENERAL ISSUES ON PRICE CAP REGULATION OF VDT

Cox asserts that LEC provision of video programming along with VDT transport amounts to cable service which is subject to Title VI and not subject to Title II or price cap regulation.² Cox's argument is misplaced and wrong. NYNEX showed in its pleadings submitted in response to the 4th FNPRM that Title VI does not apply when

¹ The NYNEX Telephone Companies are New England Telephone and Telegraph Company and New York Telephone Company.

² Cox 4.

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programming is provided by an affiliate of the common carrier VDT provider, as planned by NYNEX.³

Pacific Bell (at pp. 1, 4) urges that for price cap LECs that opt for a no-sharing price cap plan,⁴ VDT should be excluded from price caps. However, because it will be a nascent service facing fierce competition, VDT should be excluded from price caps for all LECs. Moreover, excluding VDT from the sharing and low end adjustment mechanisms, as NYNEX has proposed, should obviate any cross-subsidy concern which appears to underlie Pacific Bell's proposal.

With respect to establishment of a separate VDT price cap basket, NYNEX disagrees with Ad Hoc's proposal to include in such basket other similar broadband transport and distribution related services.⁵ It is premature to assume that any new "transport or distribution related" services should be included within the VDT basket as they are not yet known in terms of structure or packaging. When and if any new services of this type are made available, a determination should then be made as to the price cap basket in which they should be placed. That determination should be based on such

³ Telephone Company-Cable Television Cross-Ownership Rules, CC Docket No. 87-266, Fourth Further Notice of Proposed Rulemaking ("4th FNPRM"), released January 20, 1995. Cox maintains that "treatment of LEC video programming as a Title VI service is the best way to achieve the Commission's goals of regulatory parity between similar services." Cox 5. Cox's notion of regulatory parity should be viewed with some skepticism. In its Comments in response to the 4th FNPRM, Cox stated (at p. 17): "The Commission must review and monitor telephone company proposals to construct and provide service over video facilities to prevent cross-subsidization and other predatory conduct, pursuant to Section 214, whether the telephone company's service is regulated as Title II video dialtone service or as Title VI cable service." Regulatory parity would dictate that telephone companies be freed from burdensome Section 214 and other regulatory requirements applying to VDT but not to competing cable service.

⁴ See CC Docket No. 94-1, LEC Price Cap Performance Review, First Report and Order released April 7, 1995.

⁵ Ad Hoc 10.

scriteria as the degree of cross-elasticity with VDT and the availability of competitive alternatives.⁶

II. IMPLEMENTATION ISSUES REGARDING A VDT PRICE CAP BASKET

A. Productivity Factor

At the outset, Ad Hoc recommends that a new VDT basket should reflect a zero productivity factor ("X-factor") to ensure parity with the Commission's treatment of cable television services with which VDT services will most directly compete.⁷ NYNEX agrees. However, Ad Hoc goes on to propose an X-factor "disaggregation" which includes an increase in the X-factor for the non-video baskets, such that the average is held constant.⁸ Ad Hoc suggests that disaggregation of the recently adopted 5.3% composite X-factor (for LECs opting for no sharing)⁹ would imply an 8.8% X-factor for voice/narrowband baskets and a 0% X-factor for video and broadband.¹⁰ Ad Hoc's recommendation to "disaggregate" the X-factor based on the introduction of VDT is arbitrary and unreasonable and should be rejected. There is no basis for any adjustments

⁶ BellSouth recommends that VDT be integrated into the existing price cap structure, i.e. that VDT be incorporated into the Trunking basket with other transport services. BellSouth 5. NYNEX disagrees because: 1) the creation of a separate VDT basket will facilitate a transition to streamlined regulation; 2) integrating VDT into the Trunking basket is inappropriate as there is no cross-elasticity of demand between VDT services and existing transport services -- the principal criterion which should be used in determining placement of services within price cap baskets; and 3) integration of VDT into the existing price cap baskets would prove administratively difficult to the extent that VDT is treated differently in terms of productivity factor and/or the removal from the sharing/low end adjustment mechanisms.

⁷ Ad Hoc 11-12. Additionally, Ad Hoc states that "it is difficult to imagine that LEC video dialtone productivity in the near term would be greater than that enjoyed by the incumbent cable television systems." Ad Hoc 12.

⁸ Ad Hoc 12-13.

⁹ See Docket 94-1 First Report and Order, *supra*.

¹⁰ Ad Hoc 16.

to the other price cap baskets as a result of the introduction of VDT. There are simply no historical data to suggest any potential impacts on access productivity as a result of the introduction of VDT.

The Commission should also reject MCI's position that "based on the lack of historical perspective and data, it would be virtually impossible for the Commission, or any other interested party, to derive reasonable estimates for productivity factors and consumer productivity dividends that are different from those already existing in the price cap formula."¹¹ Again, a zero X-factor for VDT is warranted to provide regulatory parity with incumbent cable monopolists. Furthermore, the selection of a productivity factor for a newly created VDT basket should be based on historical productivity with respect to provision of the service. As VDT is an emerging new service unlike existing services, no historical data exist which can be used to determine an appropriate productivity factor for the VDT basket. This fact warrants a zero X-factor for VDT.

VDT does not resemble other price cap services given its unique characteristic of transmitting the video services of multiple program providers to end users on a common carrier basis.¹² Further, the technical characteristics of VDT are not similar to other services. VDT will utilize a different infrastructure platform, i.e. one that is primarily oriented to distribution or loop facilities as opposed to the interoffice network. VDT will also have different competitive characteristics as it will compete in a different market (the delivery of multi-channel video programming) and be targeted to a different customer

¹¹ MCI 10.

¹² Notice at ¶¶ 8, 11. See also CC Docket No. 87-266, 7 FCC Rcd. 5781 (1992) ("VDT Order") at 5840, 10 FCC Rcd. 244 (1994) ("VDT Recon. Order") at 309.

base (primarily video programmers). Finally, VDT will start with a zero customer base and is projected to have a gradual “ramp-up” of demand.

Moreover, the productivity factors employed in the other price cap baskets are not appropriate for a VDT basket.¹³ The productivity factors employed in the original price cap plan, and revised in the LEC Price Cap Performance Review, were based on the historical productivity of traditional LEC interstate access services and “did not include information concerning the LECs’ provision of video dialtone service.”¹⁴

B. Price Floor

NCTA asserts that the addition of a price floor for VDT would help inhibit telephone companies from cross-subsidizing the cost of that service. According to NCTA, a price floor would help inhibit VDT providers from setting VDT prices at “inefficiently low levels.”¹⁵ However, NCTA provides no basis for revisiting the price floor issue which was addressed in the VDT Recon. Order; and NCTA’s comments reflect a misunderstanding of the workings of price cap regulation.¹⁶ Moreover, NCTA makes a transparent strategic attempt to arbitrarily push up LEC VDT prices so that cable operators can price below such an umbrella for competitive gain.

¹³ NYNEX 6.

¹⁴ Notice at ¶ 16. The Commission should also reject Southwestern Bell’s proposal (at p. 5) that “for an interim period, the Commission should adopt a productivity offset based on an average of the minimum productivity factor of 4.0% that was adopted in the LEC Price Cap Review Order, and the 0% productivity factor in the cable television price cap plan.” As discussed above, while the 0% input is supported by regulatory parity, the 4.0% input is entirely inapplicable to VDT and must be removed from the equation.

¹⁵ NCTA 7. See also CCTA 7.

¹⁶ The Commission previously found that its “existing rules adequately protect consumers against improper cross-subsidy and anti-competitive activity.” VDT Recon. Order at ¶ 166.

In the VDT Recon. Order, the Commission held that the price cap new services test would apply to VDT. That test applies the following price floor: “a price is unreasonably low if it is predatory; a predatory price is one that does not recover the incremental costs of providing a service.”¹⁷ The Commission went on to provide specific guidance to the effect that LECs providing VDT must include in their pricing all direct costs, *i.e.*, “the costs and cost components associated with the primary plant investment that is used to provide the service.”¹⁸

Contrary to NCTA, a price floor is not needed to prevent cross-subsidy. The exclusion of VDT from price caps, or alternatively, the creation of a separate VDT basket, will ensure that price changes in VDT cannot affect price changes in access services. As the Commission has explained:

Subdividing LEC services into baskets substantially curbs a carrier’s pricing flexibility, as well as its ability to engage in unlawful cost shifting between the broad groups of services [baskets]. Whenever a set of rates is subject to a price ceiling, carriers have no incentive to shift costs into the basket because the cap does not move in response to endogenous cost changes.¹⁹

Accordingly, there will not be any incentive to reduce VDT rates to “inefficiently low levels” that would not recover VDT costs.

¹⁷ Id. at ¶¶ 213-14.

¹⁸ Id. at ¶ 217. The Commission further defined these direct costs as any costs “reasonably identifiable as incremental costs of video dialtone service. Examples of accounts that might include reasonably identifiable incremental costs of video dialtone are those to which carriers book costs associated with land, buildings, network administration, testing, engineering, plant operations administration, product management, sales, advertising, customer services, and legal.” Id. at ¶ 219. See also RAO Letter 25, DA 95-703, released April 3, 1995, which defines video dialtone investment and expense. All other costs are considered overheads. VDT Recon. Order at ¶ 220.

¹⁹ CC Docket No. 87-313, LEC Price Cap Order, 5 FCC Rcd. 6786 (1990), ¶ 200.

Furthermore, NYNEX has proposed that VDT direct costs and revenues be excluded from interstate rate of return calculations for purposes of the sharing and low end adjustment mechanisms.²⁰ Such exclusion will foreclose any potential interaction between VDT costs and access rates and thereby allay any lingering concern about cross-subsidy.

C. Part 69 And Sharing And Low End Adjustment Mechanisms

MCI argues that the Commission has two alternatives: 1) establish a distinct Part 69 access category for VDT by requiring LECs to maintain totally separate accounts for VDT revenues, expenses and investments so as to keep those dollars from entering the jurisdictional separations process and the existing Part 69 access category assignments; or 2) allow the VDT costs to flow through the separations process and the access cost assignment process and then use subsidiary accounting techniques to expunge these amounts prior to calculating sharing or low end adjustments.²¹ MCI views the latter alternative as “unauditable and unworkable” and thus recommends the first alternative.²² MCI’s position lacks merit.

MCI suggests that the VDT access category must be calculated using a traditional fully distributed cost methodology. However, VDT pricing must meet the new services test as articulated in the VDT Recon. Order and need not carry the same amount of overhead that would be attributed using the fully distributed cost allocation formula implicit in the Commission’s Part 69 rules. The Commission has stated that “we

²⁰ NYNEX 9-10.

²¹ MCI 14-15.

²² MCI 15.

emphasize that we are not seeking to saddle video dialtone with an unreasonable proportion of overheads and other common costs. We hope and expect that video dialtone will be a successful service in the marketplace, and therefore contribute to the recovery of common costs.”²³ Indeed, the Commission in the VDT Recon. Order declined to establish a separate Part 69 category for VDT, or separate accounts for VDT, and determined that its existing rules and Part 69 waiver process are adequate.²⁴ The Commission also stated: “We view the price cap regulatory regime, and not the Part 36/Part 69 cost allocation scheme, as our primary means of protecting the telephone consumers of price cap LECs from unreasonably high rates.”²⁵

If a fully distributed cost allocation were used to remove VDT costs prior to calculation of interstate rate of return for purposes of sharing/low end adjustment mechanisms, more costs would be removed than would be covered under the Commission’s pricing rules. Since there is no economic subsidy of a service unless pricing fails to cover incremental cost, there is no rational argument for assigning more costs than required under the Commission’s pricing rules. In fact, to do so may be viewed as granting an undue advantage to access ratepayers at the expense of the new VDT service.

Accordingly, the appropriate cost amounts to exclude from the sharing/low end adjustment mechanisms are all direct costs wholly dedicated to VDT plus the VDT portion of shared investment and associated plant related expenses. These amounts will

²³ VDT Recon. Order at ¶ 220.

²⁴ Id. at ¶¶ 169, 195-99.

²⁵ Id. at ¶ 166.

be reported to the Commission on a quarterly basis.²⁶ The VDT portion of shared investment and plant related expenses can be obtained under the existing Part 36 process. To the extent that shared overheads are reflected on VDT prices, they may also be removed to calculate access rate of return.

III. CONCLUSION

The Commission should reject those parties' proposals which would artificially hamstring the LECs' VDT offerings and detract from attainment of the Commission's procompetitive goals. VDT is an emerging new service facing fierce competition and should be subject to streamlined regulation as soon as possible. Any price cap regulation of VDT should accord as much flexibility as possible to ensure timely and viable VDT offerings.

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²⁶ Id. at ¶ 173.

CERTIFICATE OF SERVICE

I certify that copies of the foregoing **NYNEX REPLY COMMENTS** were served on each of the parties listed on the attached Service List, this 17th day of May, 1995, by first class United States mail, postage prepaid.


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